Uzbekistan's Economic Prospects and Challenges[1]
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Uzbekistan has had just one president since it achieved independence in 1991; similarly, its economic system has changed little since Soviet times. President Islam Karimov was reelected to a seven-year term in 2007 and retains a vise grip on power, with few signs of democratization or increased transparency. Reform of economic policy from that of the Soviet era has been very slow and partial. Investment is concentrated in export and basic industries. Trade and development policies aim at import-substituting industrialization and self-sufficiency in food and energy through a "localization program".

Uzbekistan is a landlocked low-income country with a GNI per capita of about $1,050 in 2009. It is rich in natural resources (gold, copper, natural gas, oil and uranium), has a strong agricultural base (it is the world's fourth-largest producer of cotton), possesses a young and educated labor force and is deemed by the World Bank to have great development potential. The country is strategically located in the heart of Central Asia, is the most populous nation in the region and has relatively well-developed physical and social infrastructure. Uzbekistan's population is very young and rapidly growing. The country faces a serious employment challenge, especially in the rural areas where nearly two-thirds of Uzbekistan's people live. Despite efforts to industrialize, agriculture remains the most important sector of the economy in employment terms. Although highest priority has been given to industrialization, there are questions about the efficiency of several of the industrial investments that have been made and about their potential viability under conditions of freer market competition.

The government responded early to the global crisis and falling export prices by putting into effect a large-scale anti-crisis fiscal expansion program. The Central Bank's spent $400 million to recapitalize six major commercial banks to spur lending in rural areas and the government launched a $600 million public investment program, financed by the Fund for Reconstruction and Development. These measures helped to maintain growth momentum, especially in industry and construction.

Uzbekistan has maintained a high rate of economic growth through the current world economic crisis and is expected to do well again in 2010 and 2011. The Uzbek economy is relatively well insulated from global financial turmoil by its lack of integration with world markets and its underdeveloped domestic financial sector. However, the country does rely heavily on commodity exports and on remittance flows from Russia and Kazakhstan, so it is affected by the economic downturns experienced by many of its trading partners. FDI in infrastructure and hydrocarbons has been an additional major force in economic growth in recent years. Shortfalls in trade, remittance or investment flows in the near future would probably prompt the government to increase its own investment spending.

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Official economic statistics are regarded with considerable skepticism, but the Economist Intelligence Unit (EIU) estimates that GDP grew at about 8% in 2009 and predicts slightly faster growth rates of 8.1% and 8.3% respectively in 2010 and 2011. (The Asian Development Bank, however, puts growth at 7% in 2009 and 6.3% in 2010.) The EIU's expectation of accelerating economic growth depends on improving performance by the export sectors (notably cotton, natural gas and gold). A large increase in the price of gas exported to Europe was negotiated in 2009. Private consumption is expected to suffer from a moderate decline in remittances but will be supported by increases in government wages and social payments. Downside risks to this favorable projection include concern about President Karimov's health and uncertainty about transition arrangements should he die or retire, as well as the possibility of social unrest that could arise, given that there are few legitimate avenues for popular protest or opposition to government policies.

Macroeconomic stability has been achieved in recent years. Major progress was made in maintaining disciplined fiscal management. Budget surpluses have been registered in every year since 2003, public debt has been retired and foreign exchange reserves have been amassed.

Inflation may be higher than officially reported and may accelerate. The official rate of consumer price increase in 2009 was 8%, but the EIU estimates that the true rate of inflation is much higher than reported by the government. The EIU expects inflation to accelerate in 2010 as a result of higher world commodity prices, rapid growth in the money supply and increases in the wages and benefits paid to government workers.

The government will probably continue to allow the currency (the som) to continue to depreciate slowly as a way of promoting Uzbek exports. The IMF has recommended that the som be allowed to appreciate moderately as a way to control inflation and allow the Central Bank to reduce its reliance on indirect monetary policy tools. The government is unlikely to heed this advice, preferring to leave the som undervalued to support exports.

The government reported a small budget surplus for the first three quarters of 2009 and is expecting another surplus, equivalent to 1% of GDP, in 2010. Strong economic growth, high commodity prices and reforms to ease the tax burden have all contributed to expansion of government revenues. Tax rates on profits and personal income will be reduced by one percentage point in 2010. However, spending on social services is rising strongly and expenditure on defense and internal security will remain high. Contrary to official projections, therefore, the EIU expects the government to run small deficits (less than 0.5% of GDP) in 2009 and 2010. To support infrastructure development and investments in basic industries, the government will draw as necessary on the Fund for Reconstruction and Development, which is financed by revenue from commodity exports and held an estimated $2.7 billion in assets at the end of 2008.

The EIU ranks Uzbekistan a dispiriting 125th out of 160 countries in its quality of life index. Negative factors affecting this score include low per capita income, a lack of political freedoms and a relatively high security risk.

Although limited progress has been made in some areas (treasury reform, lightening of the tax burden and increased capitalization of banks), the pace of policy reform remains slow. The IMF has urged the government to make further progress in developing the banking system, liberalizing international trade and payments and adopting a more flexible exchange rate policy, yet there is no indication of rapid progress on any of these fronts. Large trade surpluses resulting from higher prices for Uzbek natural gas exports have provided the government with a fiscal cushion and enabled it to postpone reforms. Convertibility restrictions, difficulty in withdrawing currency from local banks, and other actions to control economic activity (for example, import and export restrictions and intermittent border closings) have constrained economic growth and private sector development.

Foreign direct investment is lower than in other transition economies. Investment is concentrated in the oil and gas sector and comes largely from Russia and China. The European Union recently eased sanctions against Uzbekistan (prompted by its human rights record), and this may result in more activity by European investors. Middle Eastern investors have also shown some interest. Nevertheless, total FDI in the near future is expected to fall below the peak levels achieved in 2007 and 2008.

Major distortions in the economy stem from the dominant role of the state, surviving elements of centralized planning and import substitution, numerous obstacles to private business, monopolies and oligopolies in many sectors and high rates of protection. Extensive government controls continue to hinder the functioning of markets and development of the private sector. Privatization has been limited and private property rights are often overridden by government actions. Uzbekistan ranked a lowly 150^{th} out of 183 countries in the World Bank's Ease of Doing Business index for 2010. It scored poorly on protecting investors (119^{th}), closing a business (125^{th}), registering property (133^{rd}), getting credit (135^{th}), dealing with construction permits (142^{nd}), trading across borders (174^{th}) and paying taxes (178^{th}). The only area in which the country's score was not low was enforcing contracts (44^{th}).

New outward migration continues. An estimated 3-5 million Uzbeks work abroad. Net emigration to Russia and Kazakhstan continued in 2009, even though some migrant workers returned home. Since both Russia and Kazakhstan countries have been hard hit by the recession, the continuing net emigration suggests that jobs must be even harder to find in Uzbekistan, where the living standard is lower than in the destination countries.

The IMF considers trade liberalization to be critical if Uzbekistan is to sustain high growth rates through private sector development. It has advised the government to lower and unify tariffs, eliminate differences in excise taxation between imported and domestic goods, remove restrictions on exports (including food items), reduce transactions costs in international trade, streamline customs procedures and accelerate efforts for WTO accession.

Liberalization is also required in the agricultural sector. Nearly all agriculture in Uzbekistan involves heavy irrigation. Excessive and inefficient use of irrigation for cotton production in the Soviet era caused the Aral Sea to shrink to one-third its original area, a notorious ecological disaster. In 2008 the President signed a decree favoring the consolidation of private farms. In general, the government controls the agricultural sector, decreeing what crops farms grow and buying products directly from the farmers to sell abroad.

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